AGENDA ITEM #2C
October 27, 2009
Action

MEMORANDUM

October 23, 2009

TO: County Council

FROM: Glenn Orlin, GO Deputy Council Staff Director

SUBJECT: **Action**—resolution to approve Local Government Debt Policy

The Management and Fiscal Policy Committee is taking up this matter at its worksession Monday afternoon, October 26. The Committee's recommendation will be announced at the Council meeting.

* * *

A recent change to State law requires the County to adopt a formal Local Government Debt Policy and submit it to the State Treasurer. The current deadline for that submission is November 1, 2009. The Department of Finance has drafted such a policy, and it was transmitted by the Chief Administrative Officer on October 8. The transmittal memo is on ©A and a draft adoption resolution is on ©B.

At introduction Councilmember Leventhal asked for the documentation that requires the County to produce this Debt Policy and transmit it to the State Treasurer. House Bill 811 and its fiscal and policy note is on ©C-O (see especially ©K) and the letter from the Treasurer is on ©P-R. The Finance Director may be able to provide some more insight as to why the legislation was developed.

The draft policy reflects the County's current policies and practices. Council staff suggests only a few minor changes, which are shown with [deleted text] and <u>added text</u> on ©1-9. The suggested changes are clarifications, rather than substantive changes in the proposed policy.

Page 3: Policy on Funding the Capital Improvements Program with Debt. The draft policy states that "Projects deemed to be debt eligible should have a useful life at least approximately as long as the debt issue with which they are funded." Council staff does not recommend changed text here, but points out the importance of the phrase "at least approximately as long." Although General Obligation bonds usually have a duration of 20 years, the Council has consistently funded with G.O. bonds a few projects (such as resurfacing projects) with as little as a 12-year life (i.e., two full CIP periods) as long as such projects do not constitute more than 10% of the funding in a bond issue. The point is that most G.O. bond-funded projects have a useful life far longer than 20 years (e.g., a land acquisition asset presumably lasts forever), and so the average useful life of the portfolio of projects funded by a bond issue is still far longer than 20 years.

Page 4: Debt Capacity as a percentage of the General Fund Revenues. There is some inconsistency in the definition of the "debt service as a percentage of the General Fund" indicator that should be held at about 10%. The law (Section 20-57(f)) refers to this indicator as "debt service as a percentage of operating *expenditures*" (*emphasis* mine), but the proposed policy—and in recent evaluations of alternative spending affordability guidelines (SAGs)—the measure has been "debt service as a percentage of operating *revenue*." At a future meeting, perhaps when the Committee next reviews the SAGs in January, this matter can be resolved. In the meantime, however, Council staff recommends that the Debt Policy be neutral by referring to this indicator as "debt service as a percentage of the General Fund" without referring to either expenditures or revenue.

Page 4: Per Capital Debt to Per Capital Income. The proposed policy states that this indicator should not "rise significantly above its current level of about 3.5 percent." However, the indicator is currently only 3.11%, and, under the recently approved SAGs, is not forecast to rise higher than 3.40% within the FY11-16 period. For accuracy the sentence should be revised to say that it should not "rise significantly above about 3.5 percent." Note that this statement is more liberal than the Council's practice, which is to keep this indicator from exceeding 3.5%, even in the longer term.

Page 7: Policy on Minimum Allocation of PAYGO. A few years ago the Executive and Council established a policy that it would budget PAYGO—cash used instead of bonds for debt-eligible projects—at a level of at least 10% of the G.O. bonds planned for issue that year. For example, the FY11 SAG plans for $325 million in G.O. bond proceeds to be spent, so the policy would dictate that at least $32.5 million be allocated to PAYGO next year. However, although the County followed this policy in its first year (FY08), due to severe operating budget shortfalls far less than 10% was allocated to PAYGO in FY09 and FY10. With the forecast of another dire budget season ahead, it is extremely doubtful that the County will allocate $32.5 million for PAYGO in FY11.

The draft policy states "The County *will* allocate to the CIP each fiscal year as PAYGO at least ten percent of the amount of general obligation bonds planned for issue that year" (*emphasis* mine). But we haven't, and most agree that it is a foregone conclusion that we won't again in FY11. Council staff recommends moderating this sentence by starting it instead with "It is the County's policy to allocate to the CIP ..."

Council staff recommendation: With these changes and a few typographical corrections, approve the draft policy transmitted by the CAO.

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OFFICES OF THE COUNTY EXECUTIVE

Isiah Leggett
County Executive

Timothy L. Firestine
Chief Administrative Officer

MEMORANDUM

October 14, 2009

TO: Phil Andrews, President
Montgomery County Council

FROM: Timothy L. Firestine, Chief Administrative Officer
Montgomery County

SUBJECT: Local Government Debt Policy

As a result of the recent enactment of the State of Maryland Chapter 693 of the Laws of 2009, there are new requirements for most local government units and public corporations and authorities that are authorized to issue debt. The first requirement is that each local government adopts a debt policy and submits the policy to the State Treasurer. The second requirement is that local governments submit information regarding any use of variable interest rate debt instruments, interest rate exchange agreements or swaps, and other derivatives including futures and options. The ongoing monitoring of these reports provides an opportunity for the State's Treasurer to assess the risk profile of local governments, State authorities, and public corporations. Local governments are also required to establish and follow an investment policy consistent with guidelines established by the State Treasurer.

The Department of Finance has already complied with the second requirement for the current year, and will include such information in the Uniform Financial Report (UFR) in future years, as required. To address the Debt Policy requirement, Finance developed the attached Debt Policy, which is consistent with the Fiscal Policy that is included with the biannual Capital Improvements Program (CIP), and also consistent with current debt issuance practices of the County government and those best practices outlined in various national Government Finance Officer's Association (GFOA) publications.

Currently, the County has received an extension to the revised submission deadline, with a new deadline of November 1st. I would appreciate you placing the attached resolution on the Consent Calendar for introduction on October 20, 2009 and subsequent adoption before the deadline. If you or other Council members have questions concerning the policy document, please contact Jennifer Barrett in the Department of Finance at 240-777-8860.

Attachment

TLF/gww

cc: Jennifer E. Barrett, Director of Finance
Joseph Beach, Director, Office of Management and Budget

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Resolution No. ________________
Introduced: ________________
Adopted: ________________

COUNTY COUNCIL
FOR MONTGOMERY COUNTY, MARYLAND

By: County Council at Request of County Executive

SUBJECT: Approval of Local Government Debt Policy

Background

1. State of Maryland Chapter 693 of the Laws of 2009 requires that each local government adopt a debt policy and submit it to the State Treasurer.

2. On October 8, 2009 the Chief Administrative Officer transmitted a recommended a Local Government Debt Policy to the Council.

Action

The County Council for Montgomery County, Maryland approves the following resolution:

The attached Local Government Debt Policy is approved.

This is a correct copy of Council action.

____

Linda M. Lauer, Clerk of the Council

HOUSE BILL 811

L6, P1 — 9lr2279
CF SB 458

By: **Delegate Heller (Chair, Joint Committee on the Management of Public Funds) and Delegates Elmore, Howard, and Levy**
Introduced and read first time: February 11, 2009
Assigned to: Appropriations

Committee Report: Favorable with amendments
House action: Adopted
Read second time: March 24, 2009

CHAPTER ______

AN ACT concerning

State Treasurer – Local Government Units – Local Debt Policies

FOR the purpose of requiring a certain report of the financial officer of a political subdivision to be submitted to the State Treasurer; requiring certain additional information to be included in the report; requiring certain financial officers to submit a certain updated report on request of the State Treasurer; repealing a requirement that certain local government investment guidelines include a certain form; requiring each local government unit to adopt a certain local debt policy; requiring a copy of the policy to be mailed to the State Treasurer; requiring the State Treasurer to send a certain notice if the State Treasurer makes certain findings regarding the policy; requiring a certain local ~~governing body~~ government unit to revise the policy under certain circumstances; requiring a local ~~governing body~~ government unit to submit a certain revised policy under certain circumstances; requiring the State Treasurer to contact a certain local government if certain requirements are not met; requiring certain financial officers to provide certain information requested by the State Treasurer; altering a certain penalty provision; altering certain definitions; defining certain terms; repealing obsolete language; making stylistic changes; making technical corrections; and generally relating to local debt policies of local government units.

BY repealing and reenacting, with amendments,
Article 24 – Political Subdivisions – Miscellaneous Provisions
Section 2–101
Annotated Code of Maryland

EXPLANATION: CAPITALS INDICATE MATTER ADDED TO EXISTING LAW.
[Brackets] indicate matter deleted from existing law.
Underlining indicates amendments to bill.
~~Strike out~~ indicates matter stricken from the bill by amendment or deleted from the law by amendment.

(2005 Replacement Volume and 2008 Supplement)

BY repealing and reenacting, with amendments,
Article 95 – Treasurer
Section 22F
Annotated Code of Maryland
(2003 Replacement Volume and 2008 Supplement)

SECTION 1. BE IT ENACTED BY THE GENERAL ASSEMBLY OF MARYLAND, That the Laws of Maryland read as follows:

Article 24 – Political Subdivisions – Miscellaneous Provisions

2–101.

(a) (1) In this section the following words have the meanings indicated.

(2) "Department" means the Department of Legislative Services.

(3) "Financial officer" means the treasurer or other financial officer of a political subdivision.

(4) "Political subdivision" includes:

(i) A county;

(ii) A municipal corporation in the State;

(iii) A special taxing district in the State; and

(iv) A public corporation of the State.

(b) (1) Except as provided in paragraph (2) of this subsection, if a political subdivision is authorized to incur debt to be redeemed from a fee, charge, or the proceeds of a levy, then within 120 days after the end of the fiscal year of the political subdivision, its financial officer shall submit **TO THE DEPARTMENT AND STATE TREASURER**, subject to § 2–1246 of the State Government Article, [to the Department] a comprehensive report on the financial condition of the political subdivision as of the end of that fiscal year.

(2) If a political subdivision subject to the provisions of paragraph (1) of this subsection has a population of more than 400,000, the report required under paragraph (1) of this subsection may be submitted within 180 days after the end of the fiscal year of the political subdivision.

(c) A report under this section shall be on the form that the Department provides.

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(d) A report under this section shall include the affidavit of the financial officer and all of the following information that applies to the political subdivision:

(1) The assessed valuation of taxable and tangible property in the political subdivision;

(2) The total indebtedness of the political subdivision;

(3) The following categories of the total indebtedness:

(i) Bond indebtedness that is redeemable from the proceeds of general and ad valorem taxes;

(ii) Temporary or floating indebtedness;

(iii) Obligations that are incurred in anticipation of tax collection;

(iv) Current bills payable;

(v) Contingent liability that results from the guaranty of an obligation of another political subdivision; and

(vi) Self–liquidating bond indebtedness;

(4) As to self–liquidating bond indebtedness:

(i) The amount of indebtedness for each project; and

(ii) The source of the revenue for its liquidation;

(5) As to each sinking fund for retirement of obligations:

(i) Each obligation for which the fund is established;

(ii) The amount of the fund; and

(iii) The manner in which money in the fund is invested;

(6) As to the tax levy for the fiscal year for which the report is made:

(i) The amount of the levy imposed;

(ii) The amount of the levy collected; and

(iii) Separate items for:

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1. The amount of any special assessment levied; and

2. The amount of that assessment collected;

(7) As to the tax levy for each of the 3 fiscal years immediately preceding the fiscal year for which the report is made:

(i) The amount of the levy imposed; and

(ii) The amount of uncollected taxes;

(8) As to the population of the political subdivision:

(i) The population in the most recent federal census; and

(ii) Any official or unofficial population estimates for the fiscal year for which the report is made;

(9) A copy of the most recent actuarial report on the pension system of the political subdivision, unless it is a county or municipal corporation and a member of the State pension system; [and]

(10) **AS TO ALL CATEGORIES OF INDEBTEDNESS:**

(I) VARIABLE INTEREST RATE DEBT INSTRUMENTS;

(II) INTEREST RATE EXCHANGE AGREEMENTS OR SWAPS; AND

(III) OTHER DERIVATIVES, INCLUDING FUTURES AND OPTIONS; AND

(11) Any other information about the financial affairs of the political subdivision that the Department finds pertinent or appropriate and necessary to show accurately the financial condition of the political subdivision.

(e) **ON REQUEST OF THE STATE TREASURER, A FINANCIAL OFFICER SHALL SUBMIT AN UPDATED REPORT ON THE INDEBTEDNESS OF THE POLITICAL SUBDIVISION AS REQUIRED IN SUBSECTION (D) OF THIS SECTION.**

(F) (1) A financial officer may not fail **TO**:

(i) [To submit] **SUBMIT** a report under this section; or

(ii) [Within 15 days after receiving notice that the Department finds the report inadequate, to resubmit] **RESUBMIT** a report that meets the

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requirements of this section **WITHIN 15 DAYS AFTER RECEIVING NOTICE THAT THE DEPARTMENT FINDS THE REPORT INADEQUATE.**

(2) ~~A~~ **IF A** financial officer ~~who~~ violates any provision of this subsection**, THE POLITICAL SUBDIVISION EMPLOYING THE FINANCIAL OFFICER** is ~~personally~~ liable to the State for a penalty of $10 for each day or part of a day for which the report is overdue.

Article 95 – Treasurer

22F.

(a) (1) In this section the following words have the meanings indicated.

(2) "Chief executive" means:

(i) For Baltimore City, the Mayor;

(ii) For a nonhome rule county, the chairman or president of the board of county commissioners;

(iii) For a charter county, the elected county executive or, if the county does not have an elected executive, the chairman or president of the county council;

(iv) For a code home rule county, the chairman or president of the board of county commissioners;

(v) For a community college, a designee of the board of trustees;

(vi) For a municipal corporation, the mayor or, if the municipal corporation does not have a mayor, the chairman or president of the municipal governing body; [and]

(vii) For the Washington Suburban Sanitary Commission, the Chairman of the Commission**;**

(VIII) FOR A PUBLIC CORPORATION, THE CHIEF EXECUTIVE OFFICER; AND

(IX) FOR AN AUTHORITY, THE EXECUTIVE DIRECTOR OR EXECUTIVE SECRETARY.

(3) (i) "Community college" includes a regional community college established under Title 16, Subtitle 2 of the Education Article.

(ii) "Community college" does not include the Baltimore City Community College.

(4) **"FINANCIAL OFFICER" MEANS THE TREASURER OR OTHER FINANCIAL OFFICER OF A LOCAL GOVERNMENT UNIT WHO IS RESPONSIBLE FOR THE INVESTMENT OF PUBLIC FUNDS OR THE ISSUANCE AND MANAGEMENT OF DEBT OF THE LOCAL GOVERNMENT UNIT.**

(5) "Governing body" means:

(i) For Baltimore City, the ~~Mayor and City Council of Baltimore~~ <u>BALTIMORE CITY BOARD OF ESTIMATES</u>;

(ii) For a nonhome rule county, the county commissioners;

(iii) For a charter county, as provided by local law, the county council or the county executive and the county council;

(iv) For a code county, the county commissioners;

(v) For a community college, the board of trustees;

(vi) For a municipal corporation, the body provided by the municipal charter; [and]

(vii) For the Washington Suburban Sanitary Commission, the Commission**;**

(VIII) FOR A PUBLIC CORPORATION, THE BOARD OF DIRECTORS; AND

(IX) FOR AN AUTHORITY, THE BOARD OF THE AUTHORITY.

[(5) "Investment manager" means the director of finance, treasurer, or other official of a local government unit who is responsible for the investment of public funds of the local government unit.]

(6) "Local government unit" means:

(i) Baltimore City;

(ii) A community college;

(iii) A county;

(iv) A municipal corporation; [or]

(H)

(v) The Washington Suburban Sanitary Commission;

(VI) A PUBLIC CORPORATION AUTHORIZED TO ISSUE DEBT; OR

(VII) AN AUTHORITY OF THE STATE AUTHORIZED TO ISSUE DEBT.

(7) (i) "Public funds" means any revenue held by a local government unit as part of:

1. A general fund;

2. A special fund;

3. A capital improvement fund;

4. A debt service fund;

5. An enterprise fund;

6. An internal service fund; or

7. Except as otherwise provided in subparagraph (ii) of this paragraph, any other account of the local government unit.

(ii) "Public funds" does not include revenues held as part of a pension fund, other postemployment benefits fund, or trust fund account.

(b) This section and the local government investment guidelines adopted by the State Treasurer under this section supersede any local law, including any charter provision, or any other public general law to the extent of any conflict.

(c) (1) (i) After consulting with local government officials, the State Treasurer shall adopt by regulation local government investment guidelines to govern the investment of public funds by local government units in a manner that will facilitate sound cash management while protecting the public and assuring that a local government unit has access to its public funds as required.

(ii) The State Treasurer's local government investment guidelines shall:

1. State the types of investments in which public funds may be invested;

2. Include guidance for the prudent investment of public funds based on cash flow projections, income, liquidity, investment ratings, and risk;

3. Require that investments by a board of education and a board of library trustees are in compliance with the local investment policy of the respective county; and

4. Prohibit borrowing of funds for the express purpose of investing those funds.

[(iii) The State Treasurer's local government investment guidelines shall include a form that local government units shall use to comply with subsection (e) of this section. The form shall be adaptable to the investment needs of each local government unit and shall require sufficient detail to identify all pertinent aspects of an investment portfolio, including any realized losses. The form also shall require that each county include investments managed in accounts for or by the board of education and the board of library trustees of the county. The form shall provide for certification as required under subsection (e) of this section.]

(2) (i) [On or before September 1, 1995, the] **THE** governing body of each local government unit shall adopt by resolution a local investment policy that:

1. Is consistent with the local government investment guidelines adopted by the State Treasurer; and

2. Meets the individual needs of the local government unit.

(ii) Promptly after the adoption of a local investment policy, the local government unit shall mail a certified copy to the State Treasurer.

(iii) If the State Treasurer determines that the local investment policy is not consistent with the local government investment guidelines adopted by the State Treasurer, the State Treasurer shall notify the local government unit and the governing body of the local government unit shall prepare and submit a revised local investment policy that is consistent with the State Treasurer's guidelines.

(3) If the governing body of a local government unit amends its local investment policy, the local government shall submit its new policy to the State Treasurer consistent with the provisions of paragraph (2) of this subsection.

[(d)] **(4)** [An investment manager] **A FINANCIAL OFFICIAL** may not invest public funds of the local government unit in a manner inconsistent with the local investment policy.

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(D) (1) (I) ON OR BEFORE SEPTEMBER 1, 2009, ~~THE GOVERNING BODY OF~~ EACH LOCAL GOVERNMENT UNIT SHALL ADOPT BY RESOLUTION, MOTION, OR ORDINANCE A LOCAL DEBT POLICY THAT:

1. IS CONSISTENT WITH THE MARYLAND CONSTITUTION, ARTICLES 23A, 24, AND 31 AND ALL OTHER APPLICABLE STATUTES, CHARTERS, AND LOCAL LAWS; AND

2. MEETS THE INDIVIDUAL NEEDS OF THE LOCAL GOVERNMENT UNIT.

(II) PROMPTLY AFTER THE ADOPTION OF A LOCAL DEBT POLICY, THE LOCAL GOVERNMENT UNIT SHALL MAIL A CERTIFIED COPY TO THE STATE TREASURER.

(III) IF THE STATE TREASURER DETERMINES THAT THE LOCAL DEBT POLICY IS NOT CONSISTENT WITH THE MARYLAND CONSTITUTION, ARTICLES 23A, 24, AND 31 OR OTHER APPLICABLE STATUTES, CHARTERS, OR LOCAL LAW:

1. THE STATE TREASURER SHALL NOTIFY THE LOCAL GOVERNMENT UNIT; AND

2. THE ~~GOVERNING BODY OF THE~~ LOCAL GOVERNMENT UNIT SHALL PREPARE AND SUBMIT A REVISED LOCAL DEBT POLICY.

(2) IF THE ~~GOVERNING BODY OF A~~ LOCAL GOVERNMENT UNIT AMENDS ITS LOCAL DEBT POLICY, THE LOCAL GOVERNMENT SHALL SUBMIT ITS REVISED POLICY TO THE STATE TREASURER CONSISTENT WITH THE PROVISIONS OF PARAGRAPH (1) OF THIS SUBSECTION.

(e) [(1) This subsection only applies to a local government unit whose total annual expenditures for total operations, as reported in the most recent publication by the Department of Legislative Services entitled "Local Government Finances in Maryland", exceed $1,000,000.

(2) (i) On or before January 15 and July 15 of each year, beginning October 1995 and continuing through October 1999, the investment manager shall complete the form adopted by the State Treasurer to report all investments of the local government unit on the close of the final day of the immediately preceding half of the fiscal year.

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(ii) The investment manager shall certify the accuracy of the form and that the investments reported on the form are in compliance with the local investment policy and promptly submit the form to the chief executive.

(3) (i) On or before January 30 and July 30 of each year, beginning October 1995 and continuing through October 1999, the chief executive shall review the form received from the investment manager.

(ii) The chief executive shall certify the date on which the form was received and that the chief executive has reviewed the form to verify that the information complies with the local investment policy and promptly mail a copy of the completed certified form to the State Treasurer.

(4) The State Treasurer shall review the forms to verify that the chief executive, a governing body, or an independent auditor engaged by the chief executive or a governing body has certified their compliance with this section and the local government investment guidelines.

(f)] (1) The State Treasurer shall contact the local government unit to seek compliance if a local government unit fails to:

(i) Adopt a local investment policy that is consistent with the local government investment guidelines adopted by the State Treasurer; or

(ii) [Comply with the reporting requirements under subsection (e) of this section] **ADOPT A LOCAL DEBT POLICY IN ACCORDANCE WITH (D)(1)(I) OF THIS SECTION.**

(2) **ON REQUEST OF THE STATE TREASURER, A FINANCIAL OFFICER SHALL PROVIDE TO THE STATE TREASURER, IN THE FORMAT AND TIME FRAME REQUESTED:**

(I) A REPORT OF THE LOCAL GOVERNMENT INVESTMENT PORTFOLIO; OR

(II) A REPORT OF THE LOCAL GOVERNMENT DEBT PORTFOLIO IN THE FORMAT REQUIRED UNDER ARTICLE 24, § 2-101 OF THE CODE.

(3) If the local government unit [continues to fail] **FAILS** to comply with this subsection, the State Treasurer shall notify in writing the Joint Committee on the Management of Public Funds.

[(3)] **(4)** The Joint Committee on the Management of Public Funds may request the Attorney General to seek judicial enforcement against the local government unit.

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SECTION 2. AND BE IT FURTHER ENACTED, That this Act shall take effect October 1, 2009.

Approved:

Governor.

Speaker of the House of Delegates.

President of the Senate.

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Department of Legislative Services
Maryland General Assembly
2009 Session

FISCAL AND POLICY NOTE

House Bill 811 (Delegate Heller, *et al.*) (Chair, Joint Committee on the Management of Public Funds)

Appropriations Budget and Taxation

State Treasurer - Local Government Units - Local Debt Policies

This bill requires each local government to adopt a local debt policy and submit the policy to the State Treasurer by September 1, 2009. If the policy is altered, it must be resubmitted to the State Treasurer. At the request of the State Treasurer a local government must provide a report on its investment or debt portfolio. The definition of a local government is amended to include public corporations and authorities of the State that issue debt in order to expand the entities that report investment and debt information to the State Treasurer.

Local political subdivisions are also required to submit the comprehensive annual financial reports that are currently submitted to the Department of Legislative Services (DLS) to the State Treasurer. The required components of this annual report are expanded to include indebtedness from variable interest rate debt instruments, interest rate exchange agreements or swaps, and other derivatives, including futures and options.

Fiscal Summary

State Effect: None. The State Treasurer's Office can handle the bill's requirements within existing budget resources.

Local Effect: Most local governments can develop and adopt a local debt policy and comply with the reporting requirements with existing budgeted resources. Any additional costs are assumed to be minimal.

Small Business Effect: None.

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Analysis

Current Law: Each local government is required to annually submit a comprehensive report on its financial condition to DLS. State law specifies what must be included in this report, which includes the total indebtedness and types of debt.

Local governments also are required to establish and follow an investment policy consistent with guidelines established by the State Treasurer. For this requirement, local government includes Baltimore City, counties, municipalities, community colleges, and the Washington Suburban Sanitary Commission.

Background: Public corporations of the State include the Maryland Economic Development Corporation, Maryland Agricultural & Resource-Based Industry Development Corporation, and Maryland Technology Development Corporation. Some example of authorities include the Maryland Transportation Authority, Maryland Stadium Authority, Maryland Food Center Authority, and Maryland Health and Higher Education Facilities Authority.

State Fiscal Effect: The State Treasurer advises that some staff time will be required to monitor the receipt of the required reports and notify local governments that are not in compliance. The ongoing monitoring of these reports can be handled by existing staff. Furthermore, requiring State authorities and public corporations to establish and submit debt policies provides an operational benefit to the State Treasurer by making it easier to assess the risk profile of local governments, State authorities, and public corporations.

Local Fiscal Effect: DLS advises that many counties and municipalities currently report much of the required information in the annual audit report and the Uniform Financial Report submitted annually to DLS. Most local governments will expend some additional staff time to develop and adopt a debt policy, but the impact is expected to be minimal and absorbable within existing budgeted resources.

Additional Information

Prior Introductions: None.

Cross File: SB 458 (Senator Jones, *et al.*) (Chair, Joint Committee on the Management of Public Funds) - Budget and Taxation.

Information Source(s): Charles, Frederick, Montgomery, and Somerset counties; City of Bowie; State Treasurer's Office; Department of Legislative Services

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Maryland STATE TREASURER
Investing for Maryland's future.

Nancy K. Kopp
State Treasurer

Bernadette T. Benik
Chief Deputy Treasurer

July 29, 2009

Dear Financial Officer:

There are two requirements resulting from the recent enactment of Chapter 693 of the Laws of 2009. The first is that each local government unit adopt a local debt policy and submit this policy to the State Treasurer. The second requires that local government units submit information regarding indebtedness from variable rate debt instruments, interest rate exchange agreements or swaps, and other derivatives including futures and options to both the State Treasurer and the Department of Legislative Services.

Requirement 1 – Submission of Debt Policy

The specific mandate can be found in the Annotated Code of Maryland, Article 95, Section 22F (d).

> *Each local government unit shall adopt by resolution, motion, or ordinance a local debt policy that:*
> - *Is consistent with the Maryland Constitution, Articles 23A, 24, and 31 and all other applicable statutes, charters, and local laws; and*
> - *Meets the individual needs of the local government unit.*

To obtain more information on developing a debt policy, the Government Financial Officers Association (GFOA) offers a Recommended Practice on Debt Management Policy. This document can be found at www.gfoa.org/downloads/debt-management-policy.pdf.

LOUIS L. GOLDSTEIN TREASURY BUILDING, 80 CALVERT ST., ROOM 109, ANNAPOLIS, MD 21401
410-260-7533 DIRECT • 800-974-0468 TOLL FREE • 800-735-2258 TTY • 410-260-7160 TREASURER • 410-260-7390 CHIEF DEPUTY TREASURER
410-260-7934 Administration • 410-260-7270 Banking Services • 410-260-7155 Debt Management • 410-260-7684 Insurance • 410-260-7100 Information Technology • 410-260-7120 Investments

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The law requires that the local government unit shall adopt the debt policy. Therefore, please mail a certified copy of your debt policy as well as a copy of the resolution, motion, or ordinance approving the policy no later than October 1, 2009 to the State Treasurer's Office address at the end of this letter. If your jurisdiction is not authorized to issue debt, in lieu of submitting a debt policy, please notify the Treasurer's Office via letter no later than October 1, 2009 that debt is not authorized for your local government unit. Finally, please also include the name, address, phone number, and email address of the financial officer of the governmental unit submitting the policy.

Requirement 2 – Report on Variable Rate Debt, Interest Rate Exchange Agreements or Swaps, and Other Derivatives Including Futures and Options

Chapter 693 also includes amendments to the Annotated Code of Maryland, Article 24, Section 2-101 requiring political subdivisions to submit information regarding any use of variable interest rate debt instruments, interest rate exchange agreements or swaps, and other derivatives including futures and options. Please submit information regarding the use of any of these categories of indebtedness for fiscal year 2009 by your political subdivision by filling out the attached forms. The attached forms must be mailed to both the State Treasurer's Office and the Department of Legislative Services at the addresses at the end of this letter within 120 days after the end of fiscal year 2009, or 180 days after the end of fiscal year 2009 for political subdivisions with a population of more than 400,000. For future fiscal years, the Uniform Financial Report (UFR) that is submitted to the Department of Legislative Services will be modified to add categories of debt including variable interest rate instruments, interest rate exchange agreements or swaps, and other derivatives including futures and options.

Guidance Regarding Future Amendments to Debt or Investment Policies

If a debt policy or investment policy is altered or revised, the revised and approved debt policy or revised and approved investment policy must be resubmitted to the State Treasurer.

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Mailing Address for State Treasurer's Office:
Cindy Reese
State Treasurer's Office
Louis L. Goldstein Treasury Building
Room 109
80 Calvert Street
Annapolis, MD 21401

Mailing Address for Department of Legislative Services:
Erik Timme
Department of Legislative Services
Legislative Services Building
90 State Circle
Annapolis, MD 21401

Thank you for your attention to this matter. I would be happy to respond to any questions or provide further clarification at your request. I can be reached at 410-260-7920.

Sincerely,

Patti Konrad

Patti Konrad
Director of Debt Management

Enclosures

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Montgomery County, Maryland

Debt Policy

Table of Contents

Montgomery County, Maryland

Debt Policy

I. Introduction

Montgomery County recognizes that one of the attributes of sound financial management is a comprehensive debt policy. Adherence to a debt policy signals to residents, rating agencies and the capital markets that a government is well managed and should meet its obligations in a timely manner. The development of a debt policy is a recommended best practice by the Government Finance Officers Association. A debt policy establishes the parameters for issuing and managing debt. It improves the quality of decisions, provides justification for the structure of debt issuance, identifies policy goals, and demonstrates a commitment to long-term financial planning, including a multi-year capital plan.

Debt levels and their related annual costs are important long-term obligations that must be managed within available resources. An effective debt policy provides guidelines for a government to manage its debt program in line with those resources.

This debt policy is to be used in conjunction with the operating and capital budgets, the capital improvement program (CIP), and other financial policies.

II. Legal Framework

The Annotated Code of Maryland, Article 25A, Section 5(P), authorizes borrowing of funds and issuance of bonds up to a maximum of the sum of six percent of the assessed valuation of all real property and 15 percent of the assessed valuation of all personal property within the County. Article 25A, Section 5(P) provides that obligations having a maturity not in excess of twelve months shall not be subject to, or be included in, computing the County's legal debt limitation. However, the County includes its BANs/Commercial Paper in the calculation because it intends to repay the notes with the proceeds of long-term debt to be issued in the near future.

The Montgomery County Charter, Section 312 provides for the issuance of public debt for other than annual operating expenditures and imposes general requirements for fiscal policy: The capital improvements program must provide an estimate of costs, anticipated revenue sources, and an estimate of the impact of the program on County revenues and the operating budget. Bond issues may not be for longer than 30 years.

In November 1990, County voters approved an amendment to the Montgomery County Charter, Section 305, to require that the County Council annually adopt spending affordability guidelines for the capital and operating budgets. Spending affordability guidelines for the CIP have been interpreted in subsequent County law to be limits on the amount of County general obligation debt, which may be approved for the first and second years of the CIP and for the entire six-year period of the CIP. Similar provisions apply to debt of the Maryland-National Capital Park and Planning Commission

(M-NCPPC). These limits may be overridden by an affirmative vote of seven Councilmembers.

Chapter 20 of the Montgomery County Code sets various financial guidelines in law such as the deposit of funds, the borrowing of money generally, the activities of the Department of Finance, revenue bonds, and spending affordability.

Internal Revenue Service rules under the Tax Reform Act of 1986, as amended, provide limits on the tax-exempt issuance of public debt, and limit the amount of interest the County can earn from investment of the bond proceeds. County shares of costs for some major projects, such as those relating to mass transit and highway interchanges, are dependent upon Federal appropriations and allocations.

Federal Office of Management and Budget circular A-87 prescribes the nature of expenditures that may be charged to Federal grants. Federal legislation will influence the planning and expenditures of specific projects, such as requirements for environmental impact statements for Federally assisted road projects, and the Davis-Bacon Act, which requires local prevailing wage scales in contracts for Federally assisted construction projects.

The American Recovery and Reinvestment Act (ARRA) created a number of additional tax-advantaged forms of governmental debt. These forms of debt are expected to result in lower costs and therefore savings to taxpayers. The County will utilize beneficial provisions of the act and issue these new forms of debt where appropriate and advantageous to the County.

III. County Debt Policies

Policy on Funding the Capital Improvements Program (CIP) with Debt
Much of the CIP should be funded with debt. Capital projects usually have a long useful life and will serve future taxpayers as well as current taxpayers. It would be inequitable and an unreasonable fiscal burden to make current taxpayers pay for many projects out of current tax revenues. Bond issues, retired over approximately 20 years, are both necessary and equitable.

Projects deemed to be debt eligible should:

- Have a useful life at least approximately as long as the debt issue with which they are funded.
- Not be able to be funded entirely from other potential revenue sources, such as intergovernmental aid or private contributions.
- Special Note: With a trend towards more public/private partnerships, especially regarding projects aimed at the revitalization or redevelopment of the County's central business districts, there are more instances when public monies leverage private funds. These instances, however, generally bring with them the "private activity" or private benefit (to the County's partners) that generally make it necessary for the County to use current revenue as its funding source. It is County fiscal policy that financing in partnership situations ensure that tax-exempt debt is issued only for those

improvements that truly meet the IRS requirements for this lowest cost form of financing.

Policy on General Obligation Debt Limits
General obligation debt usually takes the form of bond issues, and pledges general tax revenue for repayment. Paying principal and interest on general obligation debt is the first claim on County revenues. By virtue of prudent financial management and the long-term strength of the local economy, Montgomery County has maintained the highest quality rating of its general obligation bonds, AAA. This top rating by Wall Street rating agencies, enjoyed by very few local governments in the country, assures Montgomery County of a ready market for its bonds and the lowest available interest rates on its debt.

Debt Capacity

To maintain the AAA rating, the County adheres to the following guidelines in deciding how much additional County general obligation debt may be issued in the six-year CIP period:

Overall Debt as a Percentage of Assessed Valuation - This ratio measures debt levels against the property tax base, which generates the tax revenues that are the main source of debt repayment. Total debt, both existing and proposed, should be kept at about 1.5 percent of full market value (substantially the same as assessed value) of taxable real property in the County.

Debt Service as a percentage of the General Fund [Revenues] - This ratio reflects the County's budgetary flexibility to adapt spending levels and respond to economic condition changes. Required annual debt service expenditures should be kept at about ten percent of the County's total General Fund [operating budget]. The General Fund excludes other special revenue tax supported funds. If those special funds supported by all County taxpayers were to be included, the ratio would be below ten percent.

Overall Debt per Capita - This ratio measures the burden of debt placed on the population supporting the debt and is widely used as a measure of an issuers' ability to repay debt. Total debt outstanding and annual amounts issued, when adjusted for inflation, should not cause real debt per capita (i.e., after eliminating the effects of inflation) to rise significantly.

Ten year Payout Ratio - This ratio reflects the amortization of the County's outstanding debt. A faster payout is considered a positive credit attribute. The rate of repayment of bond principal should be kept at existing high levels and in the 60-75 percent range during any ten-year period.

Per Capita Debt to Per Capita Income – This ratio reflects a community's economic strength as an indicator of income levels relative to debt. Total debt outstanding and annual amounts proposed should not cause the ratio of per capita debt to per capita income to rise significantly above [its current level of] about 3.5 percent.

These ratios will be calculated and reported each year in conjunction with the capital budget process, the annual financial audit and as needed for fiscal analysis.

Policy on Terms for General Obligation Bond Issues
Bonds are normally issued in a 20-year series, with 5 percent of the series retired each year. This practice produces equal annual payments of principal over the life of the bond issue, which means declining annual payments of interest on the outstanding bonds, positively affecting the pay-out ratio (see Debt Limits, below). Thus annual debt service on each bond issue is higher at the beginning and lower at the end. When bond market conditions warrant, or when a specific project would have a shorter useful life, then different repayment terms may be used.

Policy on Other Forms of General Obligation Debt
The County may issue other forms of debt as appropriate and authorized by law. From time to time, the County has issued Commercial Paper/Bond Anticipation Notes (BANs) for interim financing to take advantage of favorable interest rates within rules established by the Internal Revenue Service.

Policy on Use of Revenue Bonds
Revenue bonds are secured by the pledge of particular revenues to their repayment in contrast to general obligation debt, which pledges general tax revenues. The revenues pledged may be those of a Special Revenue fund, or they may be derived from the funds or revenues received from or in connection with a project. Amounts of revenue debt to be issued should be limited to ensure that debt service coverage ratios shall be sufficient to ensure ratings at least equal to or higher than ratings on outstanding parity debt. Such coverage ratios shall be maintained during the life of any bonds secured by that revenue stream.

Policy on Use of Appropriation-backed Debt
Various forms of appropriation backed debt may be used to fund capital improvements, facilities, or equipment issued directly by the County or using the Montgomery County Revenue Authority or another entity as a conduit issuer. Under such an arrangement, the County enters into a long-term lease with the conduit issuer and the County lease payments fund the debt service on the bonds. Appropriation-backed debt is useful in situations where a separate revenue stream is available to partially offset the lease payments, thereby differentiating the project from those typically funded with general obligation debt. Because these long-term leases constitute an obligation of the County similar to general debt, the value of the leases is included in debt capacity calculations.

Policy on Issuance of Taxable Debt
Issuance of taxable debt may be useful in situations where private activity or other considerations make tax-exempt debt disadvantageous or ineligible due to tax code requirements or other considerations. The cost of taxable debt will generally be higher because investors are not able to deduct interest earnings from taxable income. Taxable debt may be issued in instances where the additional cost of taxable debt, including legal, marketing, and other up-front costs and the interest cost over the life of the bonds, is outweighed by the advantages in relation to the financing objectives to be achieved.

Policy on Use of Interim Financing
Interim Financing may be useful in situations where project expenditures are eligible for long term debt, but permanent financing is delayed for specific reasons, other than

affordability. Interim Financing should have an identified ultimate funding source, and should be repaid within the short term. An example for interim financing would be in a situation where offsetting revenue will be available in the future to pay off a portion of the amounts borrowed, but the exact amounts and timing of the repayment are uncertain.

Policy on Use of Short Term Financing
Short term financing (terms of seven years of less) may be appropriate for certain types of equipment or system financings, where the term of the financing correlates to the useful life of the asset acquired, or in other cases where the expected useful life is long, but due to the nature of the system, upgrades are frequent and long term financing is not appropriate. Short term financings in the CIP are also of a larger size or magnitude than smaller purchases typically financed with short term Master Lease financing in the Operating Budget.

Policy on Use of Current Revenues
Use of current revenues to fund capital projects is desirable as it constitutes "pay-as-you-go" financing and, when applied to debt-eligible projects, reduces the debt burden of the County. Decisions to use current revenue funding within the CIP have immediate impacts on resources available to annual operating budgets, and require recognition that certain costs of public facilities should be supported on a current basis rather than paid for over time.

Current revenues from the General Fund are used for designated projects which have broad public use and which fall outside any of the specialized funds. Current revenues from the Special and Enterprise Funds are used if the project is associated with the particular function for which these funds have been established.

The County has the following policies on the use of current revenues in the CIP:

- Current revenues must be used for any CIP projects not eligible for debt financing by virtue of limited useful life.
- Current revenues should be used for CIP projects consisting of limited renovations of facilities, for renovations of facilities which are not owned by the County, and for planning and feasibility studies.
- Current revenues may be used when the requirements for capital expenditures press the limits of bonding capacity.
- Except for excess revenues which must go to the Revenue Stabilization Fund, the County will, whenever possible, give highest priority for the use of one-time revenues from any source to the funding of capital assets or other nonrecurring expenditures so as not to incur ongoing expenditure obligations for which revenues may not be adequate in future years.

Policy on Use of Federal and State Grants and Other Contributions
Grants and other contributions should be sought and used to fund capital projects whenever they are available on terms that are to the County's long-term fiscal advantage. Such revenues should be used as current revenues for debt avoidance and not for debt service.

Policy on Minimum Allocation of PAYGO

PAYGO is current revenue set aside in the operating budget, but not appropriated, and is used to replace bonds for debt eligible expenditures. To reduce the impact of capital programs on future years, the County will fund a portion of its CIP on a pay-as-you-go basis. Pay-as-you-go funding will save money by eliminating interest expense on the funded projects. Pay-as-you-go capital appropriations improve financial flexibility in the event of sudden revenue shortfalls or emergency spending. [The County will] It is the County's policy to allocate to the CIP each fiscal year as PAYGO at least ten percent of the amount of general obligation bonds planned for issue that year.

Policy on Operating Budget Impacts

In the development of capital projects, the County evaluates the impact of a project on the operating budget and displays such impacts on the project description form. The County shall not incur debt or otherwise construct or acquire a public facility if it is unable to adequately provide for the subsequent annual operation and maintenance costs of the facility.

IV. Debt Issuance and Structuring Policies

Credit Ratings

The County's ability to borrow cost-effectively depends upon its credit standing as assessed by the three major credit rating agencies: Moody's, Standard and Poor's, and Fitch. The Director of Finance shall be responsible for maintaining relationships with the rating agencies that currently assign ratings to the County's various debt obligations. This effort shall include providing periodic updates of the County's general financial condition along with coordinating meetings and presentations in conjunction with a new debt issue. The Director shall be responsible for determining whether or not a rating shall be requested on a particular financing, and which of the major rating agencies shall be asked to provide such rating.

Fixed or Variable Rate Mode

The County will use variable debt to balance interest rate cost risk across its debt portfolio. The use of variable rate debt allows the County to take advantage of short term interest rates, which are typically lower, as well as to provide interim financing for the general obligation bond funded portion of the capital program and to provide interim financing in instances where prepayment or restructuring is a high probability and redemption in the short term is likely. Variable rate debt secured by the County's general obligation pledge includes Variable Rate Demand Notes (VRDOs) and Bond Anticipation Notes (BANs).

Method of Sale - Competitive vs. Negotiated Sales

The County as a matter of policy shall issue its debt obligations through a competitive sale unless the Director of Finance determines that such a sale method will not produce the best results for the County. Generally, a negotiated sale process may be used when the County is attempting to market more complex bond transactions such as a new credit structure, or at times when a competitive sale does not produce bids or produces bids that are unsatisfactory to the County.

When appropriate and approved by the Finance Director, the County may elect to sell its debt obligations through a private placement or limited public offering. Selection of an institution to underwrite the debt shall be made pursuant to the selection procedures developed by the Department of Finance and consistent with other competitive procurements.

Selection of Service Providers

The Director of Finance is responsible for establishing a solicitation and selection process for securing professional services that are required to develop and implement the County's debt program. Goals of the solicitation and selection process shall include encouraging participation from qualified service providers, both local and national, and securing services at competitive prices. The solicitation and selection of process for services will comply generally with the County's Procurement requirements for such services, if appropriate.

Bond Counsel – Pursuant to Section 213 of the County Charter, the County Attorney may, with the approval of the County Council, employ special legal counsel to advise on bond and debt issuance matters. Upon advice and consultation with the Director of Finance, the County Attorney shall make recommendations to the County Council regarding the selection of bond counsel to be employed, and the duration of the employment for individual or a series of financings.

Underwriters, Remarketing Agents, Paying Agents, and Liquidity Providers – The Director of Finance shall solicit proposals from the service providers noted above for all debt issues when applicable. The principal criteria for selection will be the relative cost of the service, the experience of the provider, and the willingness of the provider to comply with the County's terms and conditions. The solicitation process shall include formation of a review committee to evaluate written proposals and, if deemed necessary, conduct oral interviews. The period for employment may relate to an individual transaction, a series of financings, or a specified period of time.

Other Services – The Director of Finance shall periodically solicit for providers of other services necessary to carry out the debt issuance activities of the County, such as printers, periodicals, appraisers, escrow agents, verification agents, and trustees. The Director may request that another party in the transaction hire these providers or the County can hire them directly. In either case, the selection of such additional service providers shall take into account an evaluation of the cost and perceived quality of service of the proposed service provider.

V. Debt Management Policies

Arbitrage Rebate Reporting - The County will comply with all arbitrage rebate requirements as established by the Internal Revenue Service and all disclosure requirements established by the Securities and Exchange Commission. This effort includes tracking investment earnings on bond proceeds, calculating rebate payments in compliance with the tax law and rebating positive arbitrage earnings to the federal government in a timely manner in order to preserve the tax exempt status of the County's outstanding debt issues.

Disbursements and Management of Accounts – The Director of Finance or a designee will be the County's Representative controlling disbursements from bond accounts held by trustees. Bond accounts include, among others, debt service reserve funds, construction/project accounts, rebate accounts, and costs of issuance accounts. At the appropriate time, upon completion of a project, the Department of Finance will proactively close the trust accounts related to a particular bond issue. This practice will ameliorate the possibility of unauthorized use of the bond proceeds and will further comply with IRS regulations relative to spend-down requirements and arbitrage rebate calculations.

Investment of Bond Proceeds – Any investment of bond proceeds shall be in accordance with the Investment Guidelines and/or Policies listed in the Trust Indenture. Selection of securities and/or providers shall be accomplished through a competitive process and bond counsel must monitor that process. If it is anticipated that the bond proceeds will be disbursed in approximately 12 months, for those shorter-lived projects where liquidity is required, funds can be managed by the trustee in a money market account.

Internal Controls and Compliance - The County will ensure that adequate systems of internal control exist to provide reasonable assurance as to compliance with applicable laws, regulations, and covenants associated with outstanding debt.

Investor Relations and Continuing Disclosure – The County will maintain compliance with disclosure standards promulgated by state and national regulatory agencies and provide on-going disclosure information to investors on its dedicated debt management and disclosure web site found at: http://bonds.montgomerycountymd.gov/. Information to be made available to the public and updated on an annual basis include the County's Annual Information Statement, to be updated and published by January 15 of each year. Also available are the County's Comprehensive Annual Financial Report (CAFR) and operating and capital improvements budgets. Information to be posted will also include reportable events pursuant to SEC Rule 15(c) 2-12, and information required in any applicable Continuing Disclosure Agreements associated with past bond issues.

Refundings - The County will monitor its outstanding debt in relation to existing conditions in the debt market and will refund any outstanding debt when sufficient cost savings can be realized. Generally, a refunding is economic at a point where the County can save, on a net present value basis, at least three percent of the amount of bonds being refunded. In cases of advance refunding, the County will purchase State and Local Government Securities (SLGs) to fund the escrow. If SLGs at not available, upon permission from the Finance Director and with guidance from bond counsel, the County may fund the escrow with competitively bid US Treasury securities.

VI. Administration and Implementation

The Director of Finance is responsible for the administration and issuance of debt including the completion of specific tasks and responsibilities included in this policy. The County will evaluate the debt policy at least every five years.